Note

Golden Parachutes: Common Sense from the Common Law

I. Introduction

With the dramatic rise in the number of corporate takeovers in the past decade, courts and commentators have been faced with an ever increasing variety of new strategies to examine and judge. While some of these practices are indeed novel, others are merely pockets of antiquity masquerading in modern clothing. Nowhere is this phenomenon more clearly illustrated than in the case of the golden parachute contract,[1] and given the popularity these contracts currently enjoy, they are likely to be a part of corporate America for some time.

Although the golden parachute has received considerable attention, the debate has generated more heat than light. Only recently have the courts had an opportunity to address the issue squarely.[2] While scholars have suggested analyses ranging from the business judgment rule[3] to insurance law,[4] the courts have been unwilling to view the golden parachute in anything but the most traditional of terms. Although the courts are correct in their instincts, the three ma-

1. One commentator has aptly noted that "incentive compensation plans have long been a staple of more traditional employment contracts. . . . [T]he golden parachute is not significantly different from these traditional forms of compensation." Johnson, *Government Regulation of Business: Golden Parachutes Revisited*, 23 Wake Forest L. Rev. 121, 123-24 (1988).

2. The most recent cases to confront the golden parachute issue are Worth v. Huntington Bancshares, Inc., 43 Ohio St. 3d 192, 540 N.E.2d 249 (1989), *aff'g* No. 52861 (Ohio Ct. App., 8th Dist., Nov. 25, 1987) and Gaillard v. Natomas Co., 208 Cal. App. 3d 1250, 256 Cal. Rptr. 702 (1989).

The *Worth* case is significant because it is the first state supreme court decision to address a pure golden parachute—a subsequent and supplemental agreement conferring rights as opposed to an initial integrated employment contract. The court upheld the validity of the golden parachute as applied to the facts of the case, while denying benefits to the recipient as a result of his lack of good faith in the exercise of the termination clause. *See infra* notes 168-213 and accompanying text. Although the court declined to make a broad pronouncement as to the validity of golden parachutes, Worth's contract was prototypical, and the court's approval of it is a good indicator of Ohio's benevolence towards such agreements.

The court in *Natomas* reversed summary judgments that had upheld golden parachutes. Although final determination must await a new trial, the court's analysis of the contracts at issue is illuminating.

The court first reversed a summary judgment that favored five inside directors who were beneficiaries of the contracts. Reasoning that they were not disinterested parties, the court declined to extend the business judgment rule to their acceptance of the parachutes. *Natomas*, 208 Cal. App. 3d at 1265-66, 256 Cal. Rptr. at 713.

The outside directors were found to have spent insufficient time considering the golden parachutes, thus necessitating further inquiry into the contracts themselves. The court made four important observations about the failure of these contracts: 1) because they were issued to existing executives after the merger was negotiated, they failed their essential purpose of attracting management; 2) because the recipients were encouraged to leave, the contracts failed to ensure continuity of management; 3) the amounts exceeded the three-year lump sum limit under the Deficit Reduction Act; and 4) the transaction was tainted with self-dealing. The summary judgment was therefore reversed. *Id.* at 1269-71, 256 Cal. Rptr. at 714-15. Although the tenor of the court's language hardly embraces golden parachutes, it nevertheless acknowledges manifold ways in which parachutes may survive judicial scrutiny.

3. *See generally* Note, *Golden Parachutes and the Business Judgment Rule: Toward a Proper Standard of Review*, 94 Yale L.J. 909 (1985).

4. *See generally* Note, *Golden Parachutes: Untangling the Ripcords*, 39 Stan. L. Rev. 955 (1987).

jor cases dealing with these executive termination agreements have used three separate analyses to arrive at similar conclusions.[5]

This Note will examine traditional contract analysis and judicial history in four areas of contract law to demonstrate the theoretical resemblance these areas bear to golden parachutes. It will be shown that there is little novel about special termination agreements and that in various forms they have long been upheld by courts, which have recognized their value to both corporations and employees. Finally, a test will be proposed for examination of golden parachutes that is based upon the salient concerns that have been raised regarding other contracts over the past century.

II. Golden Parachutes Described

Executive termination agreements, or golden parachutes, are contracts between corporations and their executive personnel guaranteeing generous severance benefits in the event of a corporate takeover.[6] The benefits include a cash payment and may also include other fringe benefits, such as insurance, automobiles, and professional dues.[7] While these agreements resemble typical employment agreements in many respects,[8] they contain several unique components. Among these are the change-of-control clause and the termination clause.[9]

The first of these so-called double triggers is the change-of-control clause, which defines with specificity the conditions under which the executive may pull his or her ripcord.[10] The clause specifies the amount of stock, acquisition of assets, or change in board composition necessary to qualify as a bona fide control change.[11] Other factors which may affect the change-of-control clause include "delisting from a stock exchange, a change of a majority of the board of directors within a certain time period, the replacement of a top executive, a breach of the employment contract by the company, or a sale by the corporation of substantially all its assets."[12] The basis for this clause has developed under federal securities laws which, though ambiguous, have through application established twenty percent stock ownership as a starting point for determining when a change of control has occurred.[13] Twenty percent is not talismanic, how-

5. The three cases are: Worth v. Huntington Bancshares, Inc., No. 52861 (Ohio Ct. App., 8th Dist., Nov. 25, 1987), *aff'd*, 43 Ohio St. 3d 192, 540 N.E.2d 249 (1989); Royal Crown Cos. v. McMahon, 183 Ga. App. 543, 359 S.E.2d 379, *cert. denied*, 183 Ga. App. 907 (1987); and Koenings v. Joseph Schlitz Brewing Co., 126 Wis. 2d 349, 377 N.W.2d 593 (1985).

6. Schreiber v. Burlington N., Inc., 472 U.S. 1, 3 n.2 (1985); 2 SHARK REPELLENTS AND GOLDEN PARACHUTES: A HANDBOOK FOR THE PRACTITIONER 425 (R. Winter, M. Stumpf & G. Hawkins eds. 1988) [hereinafter SHARK REPELLENTS]; Hood & Benge, *Golden Parachute Agreements: Reasonable Compensation or Disguised Bribery?*, 53 UMKC L. REV. 199, 200 (1985).

7. Worth v. Huntington Bancshares, Inc., No. 52861, slip op. at 14 (Ohio Ct. App., 8th Dist., Nov. 25, 1987). *See* Hood & Benge, *supra* note 6, at 203.

8. *Worth*, No. 52861, slip op. at 40.

9. Note, *supra* note 3, at 910.

10. SHARK REPELLENTS, *supra* note 6, at 427.

11. *Worth*, No. 52861, slip op. at 41.

12. Comment, *Future Executive Bail Outs: Will Golden Parachutes Fill the American Business Skies?*, 14 TEX. TECH L. REV. 615, 617 (1983).

13. SHARK REPELLENTS, *supra* note 6, at 439; Note, *supra* note 3, at 925.

ever, because the number and activity of shareholders vary greatly from company to company. A small corporation with active shareholders may need to establish fifty-one percent as sufficient to constitute a change of control, while a large corporation with inactive shareholders may need only fifteen percent.[14] Determining the appropriate percentage of stock ownership to establish a bona fide change of corporate control, therefore, is a fact-specific question best viewed along a continuum, with the smallest corporations requiring the largest percentage of single-entity holdings, and vice versa. This result also obtains under current tax law, which does not identify the percentage of stock ownership that constitutes a change of control but instead looks to "all the facts and circumstances."[15]

The second of the double triggers is the termination clause, which focuses on an event subsequent to the change of control[16]—either an actual termination or a diminution of job status or responsibility.[17] Though innocuous at first glance, the termination clause is in fact an invitation to litigation. Unique to golden parachutes is the fact that in the case of status diminution (that is, constructive termination), it is the employee who determines that such diminution has taken place, subject only to his or her good faith judgment. As Odysseus to the Siren's call, courts are irresistably drawn to investigate the circumstances surrounding constructive termination. Some of the factors the court will examine include change of the employee's title, reallocation of corporate budget, expansion or contraction of personnel in relevant divisions, and employee ascertainment of these factors. Indeed, this inquiry has proven crucial in the two most recent cases.[18] As with the change-of-control clause, the efficacy of the agreement depends in part upon the specificity with which the terminating events are defined,[19] as well as an examination of the good faith of the employee.[20]

The compensation clause of the golden parachute describes the type and amount of remuneration provided.[21] Benefits include cash payment, continued participation in certain noncash benefit plans, retention of pension benefits, and various stock option or appreciation rights.[22] It is not surprising that this area

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14. SHARK REPELLENTS, supra note 6, at 445.

15. Hood & Benge, *supra* note 6, at 216 (quoting H.R. REP. No. 861, 98th Cong., 2d Sess. 850 (1984)).

16. *Worth*, No. 52861, slip op. at 41, 54.

17. *See* Note, *supra* note 3, at 925-26.

18. In Worth v. Huntington Bancshares, Inc., No. 52861 (Ohio Ct. App., 8th Dist., Nov. 25, 1987), the court examined Worth's good faith in determining whether he had in fact suffered a diminution in status and responsibility. "To make a determination 'in good faith,' [Worth was] obliged to make a reasonable effort to gather reliable facts about [his] status and responsibilities." *Id.* at 15. It was Worth's lack of reasonable effort that proved fatal to his claim.

Similarly, in Gaillard v. Natomas Co., 208 Cal. App. 3d 1250, 256 Cal. Rptr. 702 (1989), the court asserted that the termination clause's dependence on "good reason" as cause for leaving was "so broad as to provide the executives with a ready justification to terminate their employment and collect the benefits immediately." *Id.* at 1270, 256 Cal. Rptr. at 715.

19. SHARK REPELLENTS, *supra* note 6, at 447. In one scenario, an inartfully drafted termination clause could allow an executive to retain her former position while receiving parachute payments ostensibly predicated on her departure. *See* Hood & Benge, *supra* note 6, at 202 n.13.

20. *See Worth*, No. 52861, slip op. at 14-29.

21. *Id.* at 41.

22. SHARK REPELLENTS, *supra* note 6, at 467.

has generated the most controversy, with attention focused on the reasonableness of the contract award.[23] Yet much of the uncertainty that existed in the early 1980s as to the judicial treatment that would await parachute payments has been ameliorated by recent congressional action.[24] The Internal Revenue Service has limited the amount of such payments to three times an employee's annual salary before both the employee and the corporation lose certain tax benefits.[25] The three hundred percent limit, in conjunction with reasonableness requirements,[26] provides boundaries which enhance certainty as to likely judicial response by allowing corporate compensation committees to use what amounts to a congressionally approved safe harbor in determining appropriate contract awards. It is likely that far from discouraging future parachutes,[27] the Tax Code will encourage their use. Indeed, in the recent California case *Gaillard v. Natomas Co.*,[28] the court found the three hundred percent rule to be of considerable probative value, noting that any amount beyond that figure would constitute an excessive payment.[29] Compensation, then, should remain within the three hundred percent limit, and should reflect the expected magnitude of loss upon termination, ability to gain new employment, age, transferability of skills, labor market conditions, work performed, training and experience, results obtained, and compensation paid by similarly situated businesses.[30]

Supporters of golden parachutes argue that, by providing for a safe landing in the event of a takeover-induced termination,[31] these agreements foster a sense of management objectivity that ensures that directors will operate to maximize shareholder interests.[32] Because executive entrenchment is minimized when pecuniary self-preservation is eliminated, current management is free to pursue with vigor an aggressive negotiating response to a tender offer without fear of reprisal by the acquiring company.[33]

Persuasive also is the argument that golden parachutes attract and retain qualified managers in industries with high displacement risks.[34] In an environment active with corporate takeovers, it has become increasingly difficult to per-

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23. *See* Riger, *On Golden Parachutes—Ripcords or Ripoffs? Some Comments on Special Termination Agreements*, 3 PACE L. REV. 15 (1982).

24. *See* I.R.C. § 280G (1986).

25. *Id.* §§ 280G, 4999. "Section 280G of the Code restricts the deductibility of parachute payments . . . if [it] exceeds three times the value of a 'base amount,' while section 4999 imposes a twenty percent excise tax on parachute recipients to the extent that the parachute payment exceeds that 'base amount.'" Johnson, *supra* note 1, at 129.

26. I.R.C. § 280G(b)(4)(A), (B) (1986). Reasonableness is nowhere defined in the Code, but one commentator suggests that predictive factors include "the work performed, the training and experience involved, the results obtained, the need for unusual ability and talent, the inadequacy of compensation in prior years, and the compensation paid by similar businesses for comparable services." Johnson, *supra* note 1, at 135. *See also infra* notes 223-29 and accompanying text.

27. *See, e.g.*, Johnson, *supra* note 1, at 129.

28. 208 Cal. App. 3d 1250, 256 Cal. Rptr. 702 (1989).

29. *Id.* at 1270-71, 256 Cal. Rptr. at 715.

30. Note, *supra* note 3, at 926; Johnson, *supra* note 1, at 135.

31. Note, *supra* note 4, at 958.

32. *Id. See* Note, *Golden Parachutes: Executive Employment Contracts*, 40 WASH. & LEE L. REV. 1117, 1133 (1983).

33. Note, *supra* note 4, at 959.

34. Note, *supra* note 3, at 914.

suade qualified executives to accept new positions where job security is questionable. The problem is especially acute where the company requires much firm-specific knowledge, with little application to other employers. By indemnifying prospective employees from takeover-related discharge, golden parachutes enable firms not only to attract talented executives, but also to require them to obtain the degree of specialization the company requires.[35]

Critics have argued that golden parachutes are a waste of corporate assets, rewarding executives for performing tasks they are legally and ethically bound to perform as part of their corporate duties.[36] Moreover, far from inducing corporate loyalty, it is argued that they enhance disloyalty by encouraging executives to seek mergers as a way of accelerating the benefits of their contracts.[37] Searching for the right trigger, it is further argued, will cause executives to agree to suboptimal acquisitions.[38] Even worse, some commentators speculate, golden parachutes will create both apathy and recklessness in covered executives, further harming shareholder interests.[39] Finally, critics contend that the presence of ego and the absence of fear of post-merger termination encourage managers to fight takeovers even more ruthlessly, increasing transaction costs and lowering shareholder profits.[40]

Although the foregoing arguments are helpful in identifying the areas of controversy, a lack of empirical support renders them of little predictive or analytical use. Upon close examination, their appeal is superficial, for they amount to little more than speculation and second-guessing[41] and are of little help to a judiciary that seeks objective criteria upon which to base its decisions. Yet an examination of several lines of traditional contract law will raise and answer many of the questions that have troubled courts and commentators about golden parachutes and will provide insights that give workable rules for consistent judicial analysis. This Note will now examine traditional contract law in light of the recent golden parachute cases and suggestions of commentators.

III. SEVERANCE ANALYSIS

A recent decision of the Georgia Court of Appeals, confronting the validity of a golden parachute contract, suggested one traditional approach that would

35. *Id.* at 917.

36. *See* Johnson, *supra* note 1, at 126; Riger, *supra* note 23, at 39. Indeed, it is suggested that executives are already handsomely rewarded for their services, *see* Note, *supra* note 32, at 1122-24, and that such compensation already reflects the risks inherent in today's merger-filled market. *See* Hood & Benge, *supra* note 6, at 204-05. Additionally, for those executives who are already the lucky recipients of some form of stock option plan, opponents charge that golden parachutes merely add insult to overcompensated injury. *See* Note, *supra* note 32, at 1126.

37. Note, *supra* note 4, at 961.

38. Note, *supra* note 4, at 961, 962.

39. *See* Johnson, *supra* note 1, at 126; Comment, *supra* note 12, at 621.

40. *See* Johnson, *supra* note 1, at 126; Comment, *supra* note 12, at 621.

41. One pair of commentators lamented that "it is difficult, if not impossible, to assess accurately the effect of golden parachute agreements." Hood & Benge, *supra* note 6, at 206. In the absence of any empirical study, one argument is as persuasive as another and cannot by itself further meaningful analysis. *See* Comment, *Testing the Flight of the Golden Parachute: Judicial Smooth Sailing or Turbulence Ahead?*, 11 N. KY. L. REV. 519, 530 (1984).

provide a conventional analytical framework within which to scrutinize these termination agreements. In *Royal Crown Cos. v. McMahon*,[42] the court declared that, for purposes of legal analysis, the term "golden parachute" was not by itself legally significant.[43] The court asserted that "[a] severance contract by any other name would be just as enforceable."[44] To date, courts and commentators have not examined golden parachutes in light of the principles supporting severance contracts. Unfortunately, due to the brevity of the *McMahon* decision and its failure to articulate the rationale supporting its pronouncement of the severance analysis, the opinion sheds little light on the issue and gives little substance with which to test its validity.

A. *Facts of* McMahon

McMahon was the president of Arbys, Inc., a wholly owned subsidiary of the defendant, Royal Crown Companies (Royal Crown).[45] Royal Crown, pursuant to takeover rumors, attempted to induce its staff officers and C.E.O. to remain with the company by offering them golden parachutes.[46] The contracts were offered to allay the fears of top level executives and to reinforce and encourage "the continued attention and dedication" of management personnel without the distractions attendant to a corporate takeover, all purportedly for the benefit of Royal Crown's shareholders.[47] Prior to the offer of the agreement, McMahon had no written employment contract—he was terminable at the will of either party.[48] After a subsequent takeover, and pursuant to the terms of his contract, McMahon voluntarily resigned his position. Royal Crown, however, denied his payments, and this suit followed.[49]

B. *History of Severance Contracts*

The concept of employee severance agreements is not new, with cases dating back at least as far as 1862.[50] Severance agreements have traditionally been considered offers of a unilateral contract—a submission of an offer in return for the rendition of services in employment by an employee until the occurrence of a stipulated event.[51] The offer is considered to have been accepted fully if the

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42. 183 Ga. App. 543, 359 S.E.2d 379, *cert. denied*, 183 Ga. App. 907 (1987).

43. *Id.* at 545, 359 S.E.2d at 381. *Accord* Worth v. Huntington Bancshares, Inc., 43 Ohio St. 3d 192, 196, 540 N.E.2d 249, 254 (1989).

44. *McMahon*, 183 Ga. App. at 545, 359 S.E.2d at 381.

45. *Id.* at 543, 359 S.E.2d at 380.

46. *Id.* at 543-44, 359 S.E.2d at 380.

47. *Id.* at 544, 359 S.E.2d at 380.

48. *Id.* at 543, 359 S.E.2d at 380.

49. *Id.* at 544, 359 S.E.2d at 380.

50. Lake v. Campbell, 5 L.T.R. 582 (1862), recognized that an amount of money to be received by an employee, if he remained employed until a certain date, was an amount to be considered in assessing damages for a wrongful dismissal. In other words, because the damage award could include only money the employee could claim he had earned, anything denominated as a gift could not be considered in the damage formula. The severance bonus must, therefore, have been viewed as an earned entitlement and not as a gift.

51. Chinn v. China Nat'l Aviation Corp., 138 Cal. App. 2d 98, 100, 291 P.2d 91, 92 (1955). Essentially the same observation has been made about golden parachutes. One pair of commentators notes that "[a] golden parachute agreement is a supplemental employment contract which deviates from the traditional employment

employee remains in the employ of the employer.[52] Acceptance need not be specifically communicated to the employer; it is enough that the employee performs his or her duties. The agreement will then arise by implication, provided the offer has not been withdrawn.[53] Viewed as such, severance pay is more than a mere gratuity to be paid at the will of an employer;[54] it is "remuneration for the service rendered during the period covered by the agreement."[55]

As was noted by Labatt in his 1913 treatise,

> In some contracts it is stipulated, either absolutely or conditionally, that a sum designated as a gift, gratuity, or bonus shall be payable at a certain date. Such a sum is in effect a part of the stipulated remuneration; and when the specified period has expired, the right to recover it at once accrues to the servant, provided the agreement is valid, and the specified condition . . . has been fulfilled.[56]

In an early North Carolina case, *Roberts v. Mays Mills*,[57] the court echoed Labatt when it held that a bonus offered to employees was not a gratuity, but was in fact an offer by the employer to produce efficient and faithful service for a specified period of time.[58] When an employee is induced to enter employment by means of such a bonus, the payment becomes a supplementary contract, deprivation of which cannot be achieved without sufficient cause.[59]

Without specifically addressing the issue of consideration, the Wisconsin Supreme Court, in *Zwolanek v. Baker Manufacturing Co.*,[60] noted in 1912 that certain benefits flowed to the offeror as a result of severance contracts. Severance agreements "tend to relieve the employer of the annoyance of hiring and breaking in new men to take the place of those who might otherwise voluntarily quit, and to insure a full working force at times when jobs are plentiful and labor is scarce."[61] By implication, workers covered by such agreements would be foregoing other employment opportunities in order to preserve their severance benefits, thus, according to one modern golden parachute case, incurring a detriment sufficient to support a finding of consideration.[62]

Other severance contracts were attacked, much like golden parachutes, on the grounds that the benefit constituted a payment based on past performance or pre-existing duty.[63] The objection was that the recipient was already bound

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contract in that it provides for substantial severance pay upon the occurrence of certain events specified in the agreement." Hood & Benge, *supra* note 6, at 202. At its theoretical core, the golden parachute is much the same as the severance contract; only the payout differs. *See infra* text accompanying notes 72-76.

52. Gronlund v. Church & Dwight Co., 514 F. Supp. 1304, 1310 (S.D.N.Y. 1981).

53. Zwolanek v. Baker Mfg. Co., 150 Wis. 517, 523, 137 N.W. 769, 772-73 (1912); A. CORBIN, CORBIN ON CONTRACTS § 70, at 115 (one vol. ed. 1952).

54. *Chinn*, 138 Cal. App. 2d at 100, 291 P.2d at 92.

55. *Gronlund*, 514 F. Supp. at 1310 (quoting Owens v. Press Publishing Co., 20 N.J. 537, 546, 120 A.2d 442, 446 (1956)).

56. 2 C.B. LABATT, COMMENTARIES ON THE LAW OF MASTER AND SERVANT § 452 (2d ed. 1913).

57. 184 N.C. 406, 114 S.E. 530 (1922).

58. *Id.* at 410, 114 S.E. at 532.

59. *Id.*

60. 150 Wis. 517, 137 N.W. 769 (1912).

61. *Id.* at 521, 137 N.W. at 772. High turnover is a persistent problem in today's executive market, and it is apparently on the rise. Note, *supra* note 32, at 1131-32.

62. Worth v. Huntington Bancshares, Inc., No. 52861, slip op. at 42-45 (Ohio Ct. App., 8th Dist., Nov. 25, 1987).

63. One such case is Plowman v. Indian Ref. Co., 20 F. Supp. 1, 4 (E.D. Ill. 1937).

to do his best for his salary, having done nothing in addition that would support the promise of a bonus. But the court in *H.S. Kerbaugh, Inc. v. Gray*[64] rejected this argument, asserting that "this would be true [only] if the plaintiff were legally bound to continue in the employment of the defendant."[65] Other courts likewise have dismissed this charge, noting that these contracts were "not based upon past services, but upon the employee accepting the offer of the contract by continuing in employment."[66] Where no prior obligation existed for an employee to remain with a company, as in an employment-at-will situation,[67] the only duty the employee would be obliged to fulfill would be performance of job responsibilities. By remaining with the company in exchange for the severance bonus, the agreement became a supplemental contract,[68] compensating an additional performance for which no prior duty existed.

Finally, at least one severance contract was attacked for providing an unwarranted windfall to the worker. In rejecting the argument that an immediate resignation under one such plan would trigger the same benefits as would a resignation after many years, the court in *Chinn v. China National Aviation Corp.*[69] noted that a clear reading of the contract indicated that benefits were payable based only upon years of service up to the time of termination.[70] Because the contract thus guaranteed that the benefit would fairly reflect the consideration tendered, it was not void as a gift unsupported by consideration.[71]

C. *Golden Parachutes and Severance Contracts Compared*

As an initial matter, it is striking that the rationale advanced by courts early in this century favoring and opposing severance agreements is so closely paralleled by courts and commentators today when discussing golden parachutes. McMahon's golden parachute purported to induce him to remain with Royal Crown, encouraging his continued dedication to the company.[72] The presumed benefit to the corporation was the preservation of a loyal staff of employees, saving Royal Crown from "the annoyance of hiring and breaking in new men to take the place of those who might otherwise voluntarily quit,"[73] as was so aptly noted in 1912 by the *Zwolanek* court.[74] The efficient service employers sought in exchange for the bonuses offered in 1922[75] is not dissimilar to the continued attention and dedication Royal Crown sought from its employees in 1982.[76] Indeed, in the years which have elapsed since *Zwolanek* and *Mays Mills* were decided, courts have consistently upheld severance agreements, cit-

64. 212 F. 716 (2d Cir. 1914).
65. *Id.* at 717.
66. Chinn v. China Nat'l Aviation Corp., 138 Cal. App. 2d 98, 102, 291 P.2d 91, 94 (1955).
67. *E.g.*, Roberts v. Mays Mills, 184 N.C. 406, 114 S.E. 530 (1922).
68. *Id.* at 410, 114 S.E. at 532.
69. 138 Cal. App. 2d 98, 291 P.2d 91 (1955).
70. *Id.* at 103, 291 P.2d at 94.
71. *Id.*
72. *See supra* text accompanying notes 46-47.
73. *See supra* notes 60-62 and accompanying text.
74. Zwolanek v. Baker Mfg. Co., 150 Wis. 2d 517, 521, 137 N.W. 769, 772 (1912).
75. Roberts v. Mays Mills, 184 N.C. 406, 410, 114 S.E. 530, 532 (1922).
76. *McMahon*, 183 Ga. App. at 543-44, 359 S.E.2d at 380.

ing with approval the foregoing arguments. It is hardly surprising, then, that golden parachutes should enjoy such vitality when they purport to do the very things which for years have basked in the gentle warmth of judicial approval.

As to the issue of consideration,[77] *McMahon* held that because the contract was expressly offered to induce McMahon to remain with Royal Crown, "[c]ontinued performance under a terminable-at-will contract furnish[ed] sufficient consideration for the promise of additional severance pay."[78] The holding strikes a resonant chord with *H.S. Kerbaugh*, which found a severance contract to be supported by consideration where the recipient remained at work in exchange for the bonus, when he was not otherwise legally bound to do so.[79] On the consideration issue, *McMahon* is in agreement with a long line of severance cases.

The most serious charge leveled against golden parachutes has been that they are an unwarranted windfall for corporate executives.[80] Whether the benefit is a windfall or "remuneration for the service rendered"[81] may be largely a question of analytical semantics. Yet the court in *Chinn* found the key to be a clear reading of the contract, which in that case revealed that benefits were only payable to the extent that the promised performance had accrued to the corporation.[82] It was the guarantee of a performance *in addition* to his original obligation that validated the award. Golden parachutes likewise require the promise to be performed in full before the benefits can be collected.[83] Like the severance agreement, the golden parachute consideration accrues to the corporation before benefits are paid.

Severance agreements and golden parachutes may be distinguished by both the size and the nature of the awards. McMahon, for example, received one full year's salary and other fringe benefits,[84] while Roberts in the *Mays Mills* case received only a ten percent bonus in severance.[85] Moreover, golden parachutes allow the executive to self-terminate, while severance contracts require the employer to terminate the worker. While this latter argument is rebutted by noting that constructive termination results from employer-directed actions which diminish status and responsibility, and is therefore effectively at the discretion of the new employer, severance contracts deal with much smaller payments and are in this respect inapposite to golden parachutes. Substantial severance deals may well have prompted a more stringent review by the early courts, and a

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77. *See supra* text accompanying notes 56-68.

78. *McMahon*, 183 Ga. App. at 545, 359 S.E. 2d at 381.

79. H.S. Kerbaugh, Inc. v. Gray, 212 F. 716, 717 (2d Cir. 1914).

80. Riger, *supra* note 23, at 39.

81. Gronlund v. Church & Dwight Co., 514 F. Supp. 1304, 1310 (S.D.N.Y. 1981) (quoting Owens v. Press Publishing Co., 20 N.J. 537, 546, 120 A.2d 442, 446 (1956)). *See supra* text accompanying note 55.

82. 138 Cal. App. 2d at 103, 291 P.2d at 94.

83. *See infra* text accompanying notes 127-30.

84. *McMahon*, 183 Ga. App. at 544, 359 S.E.2d at 380. Other awards have been substantially higher. For example, a golden parachute issued to the chief executive officer of Conoco in 1981 had a value of $3.5 million over eight years. Riger, *supra* note 23, at 17-20. Other parachutes have ranged from $3.1 million (Royce Diener, CEO of American Medical International) to $7.8 million (John Amos, CEO of American Family). Morrison, *Compensation: Those Executive Bailout Deals*, FORTUNE, Dec. 13, 1982, at 85.

85. Roberts v. Mays Mills, 184 N.C. 406, 408, 114 S.E. 530, 531 (1922).

blind application of the severance analysis to multi-million dollar golden parachutes would be misplaced.

Properly understood, however, the severance approach provides a conceptual point of reference from which a more complete analysis can emerge. The foregoing discussion demonstrates that the purpose and rationale behind golden parachutes are well rooted in the judicial and corporate history of this country; the parachute is a close relative of business practices long established in the corporate landscape.

IV. Stock Option Contracts

Another line of cases offering an established analytical framework for consistent judicial treatment of golden parachutes is the series of stock option cases from the state of Delaware.[86] While these cases are not squarely on point, they are quite analogous and present many of the legal issues posed by golden parachutes.

A. *Stock Options Described*

Typically, employee stock option plans allow selected employees and executives to purchase shares of stock from the corporation at prices roughly equivalent to the market value of the stock at the time the option is granted.[87] Such an offer is attractive only if the value of the stock is likely to rise, through either inflationary pressures or the hard work and diligence of the optionees.[88] It is the proprietary interest spawned by the latter consideration that provides incentive for the optionees to work for the benefit of the corporation, because the return on the option investment hinges on successful performance.

Although these option agreements are now a permanent part of American corporate practice, they produced considerable litigation at their initial appearance, the controversy focusing on sufficiency of consideration and corporate self-dealing.[89] As with severance agreements,[90] the arguments marshalled favoring and opposing stock options are strikingly similar to those heard today regarding golden parachutes.

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86. *See* Riger, *supra* note 23, at 27-29. In his critique of golden parachutes, Riger suggests an analogy between golden parachutes and stock options. Citing what he refers to as the Retention and Distraction Theses, *id.* at 28-30, Riger correctly pinpoints areas in which stock options and golden parachutes are similar. His central concern with adequacy of consideration, *id.* at 17, is also thoroughly treated in the Delaware cases. It is interesting to note that his observation that Delaware was likely to be the first state to address the golden parachute issue, due to the number of then-outstanding cases in the Delaware courts, has not come to pass. To date, not a single case on the subject has been decided in Delaware.

87. Annotation, *Validity of Stock-Option Plan Under Which Selected Personnel of Corporation May Acquire Stock Interest Therein*, 34 A.L.R.2d 852, 854 (1954).

88. *Id.*

89. *Id.*

90. *See supra* Part III.

B. *Cases Examined*

Turning first to the consideration issue, nowhere is the question more completely addressed than in *Kerbs v. California Eastern Airways, Inc.*[91] The court in *Kerbs* said that the validity of a stock option plan depended solely on the existence of consideration flowing to the corporation and the existence of circumstances or conditions guaranteeing that the corporation would receive the benefit promised by the optionee.[92] The difficult question, however, is what constitutes sufficient consideration?

Kerbs asserted that the finding of sufficient consideration will always be a fact-specific inquiry,[93] but that there must be "a reasonable relationship between the value of the services to be rendered by the employee and the value of the options granted as an inducement or compensation."[94] The court went on to include attraction and retention of employees as a valid basis for finding consideration.[95]

The *Kerbs* court was not alone in recognizing the adequacy of consideration when one is induced to work for a company by use of a stock option contract. In *McQuillen v. National Cash Register Co.*,[96] the court dismissed the failure-of-consideration argument by noting that the defendant's promise to assume the title and duties of chairman of the board of directors was by itself sufficient consideration to support the option.[97] Similarly, the court in *Wise v. Universal Corp.*[98] held that when used as an inducement to enter employment, stock options were supported by consideration.[99] This conclusion was further strengthened by the finding that the various defendants had foregone other employment opportunities and bound themselves contractually to the corporation.[100]

Kerbs was also on well-established judicial ground when it insisted upon "some circumstance[s] which may reasonably be regarded as sufficient to insure that the corporation will receive that which it desires to obtain by granting the options."[101] This concern was directed toward the retention of employees after the granting of the option. The court in *Forman v. Chesler*,[102] urging that retention of key employees was an important corporate concern,[103] upheld an option contract because the terms of the agreement required the optionees to remain on the job for at least eighteen months and forbade them from engaging in any

91. 33 Del. Ch. 69, 90 A.2d 652 (1952). *See also* Comment, *supra* note 41, at 536-40.
92. *Kerbs*, 33 Del. Ch. at 74, 90 A.2d at 656.
93. *Id.*
94. *Id. See* Note, *supra* note 4.
95. *Kerbs*, 33 Del. Ch. at 74, 90 A.2d at 656.
96. 27 F. Supp. 639 (D. Md. 1939).
97. *Id.* at 649.
98. 93 F. Supp. 393 (D. Del. 1950).
99. *Id.* at 396.
100. *Id.*
101. *Kerbs*, 33 Del. Ch. at 77, 90 A.2d at 657; *accord* Beard v. Elster, 39 Del. Ch. 153, 160-61, 160 A.2d 731, 736 (1960).
102. 39 Del. Ch. 484, 167 A.2d 442 (1961).
103. *Id.* at 492-93, 167 A.2d at 447.

competitive business for at least ten years.[104] Because of these terms the promised performance was ensured. In *Saigh v. Busch*,[105] a shareholder's derivative suit sought to set aside a stock option given to a long-time company officer, contending that his enduring tenure and then-current stock holdings rendered unlikely his departure; hence, the option was needless as an inducement to remain and was therefore a waste of corporate assets.[106] The court rejected this position, noting that the low risk of the officer's departure was far outweighed by the potential damage to the company were he to leave.[107] Thus, even a tenuous retention argument was sufficient to support a finding of consideration.

It is clear from the foregoing decisions that stock options are supported by consideration if they attract or retain employees and if they guarantee that the corporation will receive the employee's promised performance.[108] Indeed, it was the failure to guarantee performance that was fatal to the option contract in *Kerbs*.[109]

Stock options were also attacked on the grounds that they were gratuities, conjured up by well-paid executives and issued to themselves.[110] Conceived of as such, stock options can be viewed as products of executive self-dealing. However, *Wise v. Universal Corp.*,[111] in upholding an option agreement, pointed to the contract's ratification by eighty-six percent of the disinterested certificate holders and concluded that no fraud or self-dealing was present.[112] Evidently, because the shareholders were informed and approved the action prior to issuance, no self-dealing would be found. In *Kerbs* the plaintiffs argued that because five of eight directors who approved the plan were its beneficiaries, the board's action was illegal.[113] This argument failed, however, because a majority of disinterested stockholders ratified the plan, thus curing any defect in the board's action.[114] In the above cases, full disclosure and stockholder approval removed all doubts concerning fraud and executive self-dealing.

C. *Golden Parachutes and Stock Options Compared*

The *Kerbs* case established a two-prong inquiry for determining the validity of stock option contracts: the existence of consideration, and circumstances surrounding the contract ensuring that the contemplated consideration would in fact pass to the corporation.[115]

It cannot be doubted that golden parachutes pass the first prong of the test. Their increasing popularity indicates that they are effective in attracting and

104. *Id.*
105. 403 S.W.2d 559 (Mo. 1966).
106. *Id.* at 564.
107. *Id.*
108. Frankel v. Donovan, 35 Del. Ch. 433, 438, 120 A.2d 311, 314 (1956).
109. *Kerbs*, 33 Del. Ch. at 75, 90 A.2d at 656.
110. Annotation, *supra* note 87, at 854.
111. 93 F. Supp. 393 (D. Del. 1950).
112. *Id.* at 397.
113. *Kerbs*, 33 Del. Ch. at 78-79, 90 A.2d at 658.
114. *Id.*
115. *Id.* at 74, 90 A.2d at 656.

retaining executives,[116] so much so that companies assert that they must offer such a deal if they are to be at all competitive in their recruiting.[117] *Kerbs* explicitly found attraction and retention to be consideration sufficient to support a stock option.[118] Because golden parachutes also attract and retain employees, they are likewise supported by consideration. Indeed, it was the retention of employees that was intended in the golden parachute issued in *McMahon*, just as *Worth v. Huntington Bancshares, Inc.*[119] and *Koenings v. Joseph Schlitz Brewing Co.*[120] illustrate the golden parachute's effectiveness in retaining employees during takeover negotiations. In fact, retention is the reason most often cited by the courts for validating golden parachutes. In *Buckhorn, Inc. v. Ropak Corp.*,[121] golden parachutes were held to be a reasonable response to a threatened takeover, primarily because the agreements would retain key employees without present costs accruing to the corporation.[122] Retention was viewed as furthering shareholder interests[123] and was thus a valid corporate purpose.

Critics assert that attraction and retention alone are not enough to support a finding of consideration.[124] Regarding retention, it has been persuasively argued that "[c]orporate executives have a pre-existing duty to give the proper attention and dedication to their corporate duties by virtue of statutes, their employment contracts, and/or basic business ethics."[125] In other words, when one does that which he is already obligated to do, that action is the performance itself, not the giving of consideration.[126] Again, this argument is answered by noting that while an executive is obligated to act in the best interests of the corporation, he or she is not obligated to work in perpetuity for it. The golden

116. G. DWYER, "GOLDEN PARACHUTES" AND CORPORATE TAKEOVERS—A NEW SURVEY (1983) (Ward Howell International).

117. Profusek, *Executive Employment Contracts in the Takeover Context*, 6 CORP. L. REV. 99, 100 (1983). This perception was acknowledged by John P. Finnerty, senior vice president of human resources for National Westminster Bank, who, when asked why he awarded golden parachutes to two new employees, responded: "We couldn't have gotten them without it." Deutsch, *When a Handshake Isn't Enough*, N.Y. Times, Feb. 4, 1990, at F29, col. 3.

118. *Kerbs*, 33 Del. Ch. at 74, 90 A.2d at 656.

119. No. 52861, slip op. (Ohio Ct. App., 8th Dist., Nov. 25, 1987).

120. 126 Wis. 2d 349, 377 N.W.2d 593 (1985).

121. 656 F. Supp. 209 (S.D. Ohio), *aff'd*, 815 F.2d 70 (6th Cir. 1987).

122. 656 F. Supp. at 232-33.

123. *Id.*

124. *See* Riger, *supra* note 23, at 29.

125. Note, *Platinum Parachutes: Who's Protecting the Shareholder?*, 14 HOFSTRA L. REV. 653, 666 (1986). Another commentator has asserted that "management should not require additional compensation to perform the job for which it was originally hired." Comment, *supra* note 41, at 533. Moralizing aside, it is one-sided to characterize the offering of a golden parachute as "required" by management when these agreements are freely given by independent compensation committees, in whose discretion the law confers decisionmaking on remunerative policy. The fact that parachutes are often given to mid-level employees, who presumably have little bargaining power, suggests that other factors motivate compensation committees. Clearly, if "additional" compensation can be said to have been "required," it can as easily be said to have been "offered."

Mounting this treadmill of verbiage is, however, of no value to the analysis of the real issue at hand: the obligation of an employee to remain with an employer when he is not otherwise bound to do so. A golden parachute is no more an "additional compensation" than is a severance contract. *See supra* Part III. Such a sum is in effect a part of the stipulated remuneration, *see supra* text accompanying note 55, not an amount in addition to the originally agreed upon sum.

126. Ruffin v. Mercury Record Prods., Inc., 513 F.2d 222, 224 (6th Cir. 1975).

parachute induces the employee to remain with a company during a takeover where no prior obligation would compel him or her to do so. The critics who suggest that during merger activity the duty to perform with dedication and vigor is inherent to corporate employment are doubtless correct. But while there may be a moral obligation to perform, there is no legal one. Absent a written employment contract, an executive has no legal obligation to remain on the job. In other words, in an employment-at-will situation, there is no pre-existing duty to perform, because the executive is not compelled to remain with the company during a takeover.

It is also clear that the nature of the golden parachute satisfies the second prong of the *Kerbs* test, that the circumstances guarantee the contemplated consideration to flow to the corporation.[127] In *McQuillen* the court noted that despite the existence of a statute prohibiting the issuance of stock for future services, the contract was valid because it purported only to allow for future delivery of stock if and when the services were periodically completed.[128] Because the stock delivery was contingent upon successful performance of corporate duties, no stock could be obtained unless the promised performance flowed to the company, thereby supporting the bargain.

Golden parachutes, by their very construction, require a similar performance. Because the object of the promised performance is for the employee to remain with the company during a takeover struggle, and because the takeover must be consummated before the contract can be exercised, the promised performance is absolutely guaranteed. Like *McQuillen*, in which future delivery of stock was contingent upon completion of future services, the future delivery of parachute payments is contingent upon remaining with the company throughout the merger—a future service.[129] The employee cannot collect until he or she performs. Moreover, with regard to past consideration, when the takeover occurs after the golden parachute is issued, there is no past service to compensate for, because the service the contract seeks does not come into existence until takeover negotiations begin.[130] Hence, the golden parachute cannot compensate for past service.

As shown above, golden parachutes adhere to the requirement of the *Kerbs* test, demonstrating that *Kerbs* affords an analytical framework with which to analyze the golden parachute. Because golden parachutes attract and retain employees, do not compensate for past service or pre-existing duty, and guarantee the performance they seek, they are valid under the *Kerbs* test.

V. Liquidated Damages Analysis

Golden parachutes have also appeared as clauses for stipulated damages in a written employment contract, as in the Wisconsin case *Koenings v. Joseph*

127. *See supra* notes 101-07 and accompanying text.

128. McQuillen v. National Cash Register Co., 27 F. Supp. 639, 649 (D. Md. 1939). *See also* Hood & Benge, *supra* note 6, at 222-23 (citing Ash v. Brunswick Corp., 405 F. Supp. 235, 240 (D. Del. 1975)).

129. *McQuillen*, 27 F. Supp. at 649.

130. Hood & Benge, *supra* note 6, at 224-25.

Schlitz Brewing Co.[131] In that case Koenings, a senior staff attorney with Schlitz Brewing Company, brought an action against his employer for damages under an employment contract entitling him to receive a salary for the balance of the contract term, provided he suffered a termination or reduction in job status resulting from a takeover.[132] Subsequent to a merger, Koenings exercised his option and went immediately to another company, where he received the same salary he had received at Schlitz.[133] Schlitz denied his benefits, arguing that because he suffered no takeover-related loss,[134] he had a duty to mitigate his damages.

A. *Liquidated Damages Described*

Generally, liquidated damages are contractual provisions that preset an amount payable to a party injured by a breach of contract.[135] In determining the validity of such clauses, courts will inquire as to: 1) whether the parties intended to provide damages or a penalty; 2) whether the injury caused by the breach was difficult or impossible to ascertain at the time the contract was executed; and 3) whether the stipulated damages were a reasonable forecast of the harm caused by the breach.[136] If a reasonable relation is found between the anticipated and actual damages, the contract will not be void as unconscionable or against public policy.[137] However, if the anticipated and actual damages greatly diverge, or if the clause was intended to compel performance, it will be deemed a penalty and will not be enforced.[138] Finally, if the amount is found to be reasonable, no duty to mitigate damages will arise.[139]

B. *Analysis*

The *Koenings* court, in its liquidated damages analysis, identified two salient issues that are also sharply disputed by critics of golden parachutes: whether the damage clause was reasonable[140] and whether a duty to mitigate damages arose.[141]

As an initial matter, however, it is startling that the court never mentioned the termination clause of the parachute in its opinion. In upholding the lower court,[142] the Wisconsin Supreme Court apparently decided that Koenings did

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131. 126 Wis. 2d 349, 377 N.W.2d 593 (1985).

132. *Id.* at 353-54 n.2, 377 N.W.2d at 596 n.2.

133. *Id.* at 355, 377 N.W.2d at 597.

134. *Id.* at 367-68, 377 N.W.2d at 602-03.

135. *E.g.*, Layton Mfg. Co. v. Dulien Steel, Inc., 277 Or. 343, 346-47, 560 P.2d 1058, 1060 (1977).

136. *Id.*; Higgs v. United States, 546 F.2d 373, 377 (Ct. Cl. 1976); Wassenaar v. Panos, 111 Wis. 2d 518, 529-30, 331 N.W.2d 357, 363 (1983).

137. Leasing Serv. Corp. v. Justice, 673 F.2d 70, 73 (2d Cir. 1982).

138. Brecher v. Laikin, 430 F. Supp. 103, 106 (S.D.N.Y. 1977).

139. *Wassenaar*, 111 Wis. 2d at 521, 331 N.W.2d at 359.

140. Koenings v. Joseph Schlitz Brewing Co., 126 Wis. 2d 349, 358, 377 N.W.2d 593, 598 (1985).

141. *Id.* at 361, 377 N.W.2d at 599.

142. Koenings v. Joseph Schlitz Brewing Co., 123 Wis. 2d 490, 368 N.W.2d 690 (Ct. App. 1985).

not terminate his employment voluntarily.[143] The court agreed with the jury below, which found that Koenings' status and responsibility had indeed been reduced because of the takeover.[144]

Critics of golden parachutes have questioned the propriety of allowing an employee to determine for him or herself when job status has been reduced, and they suggest that such unconditional mechanisms should be invalidated.[145] However, in the context of any agreement enumerating specific conditions of employment, the employer has undertaken specific promises, the failure of which to perform constitutes a breach of the contract. The employer, therefore, by breaching its promises, is responsible for the termination, not the employee. Hence, termination is necessarily involuntary. Self-termination is a misnomer.

A job-related termination trigger, such as the one Koenings had, is to be distinguished from an illusory trigger. Critics correctly argue that a contract requiring only minimal triggering events, such as a change of office location[146] or an unconditional termination right,[147] should be invalidated because the employee has suffered no meaningful takeover-related harm. An unconditional termination right is best understood as an illusory promise, because the performance accruing to the corporation is simply too insubstantial to support the corporation's obligation to pay the employee.[148] To argue that a mere change in office location would impair an employee's ability to perform "would require a degree of naiveté which should not be demanded even of judges."[149] Such a clause would truly be a self-terminating trigger and would not fulfill the dual object of the corporation's bargain—to retain employees during *and* after a merger absent constructive or actual termination.

The *Koenings* court addressed the reasonableness of the damage award by applying a totality-of-the-circumstances test.[150] Focusing on whether the damages were a reasonable forecast of harm caused by the breach, the court looked not only at actual damages but also at consequential damages, rejecting Schlitz's argument that such damages were outside the scope of the parties' original contemplation.[151] By allowing evidence of compensatory damage into the original forecast, including salary, benefits, prestige, and emotional distress, the court broadened the spectrum of damages it considered, thus harmonizing what otherwise would have been a wide discrepancy between the stipulated and actual damages.

143. Koenings v. Joseph Schlitz Brewing Co., 126 Wis. 2d 349, 354, 377 N.W.2d 593, 596-97 (1985). The court's silence on this point is presumed to indicate its approval of the termination clause. Indeed, there would have been no reason for the court to reach the mitigation of damages issue had this threshold not been met.

144. *Id.* at 355 n.4, 377 N.W.2d at 597 n.4.

145. Note, *supra* note 3, at 925.

146. Profusek, *supra* note 117, at 107.

147. Note, *supra* note 32, at 1120 n.9.

148. In the extreme case, it is difficult to justify the paradox of an executive exercising his or her termination rights under the contract, only to remain in the employ of the corporation. *See, e.g.*, Hood & Benge, *supra* note 6, at 202 n.13. Although it may be argued that the organization in this situation received the benefit of its bargain—employee retention during the takeover attempt—so incongruous a result would be intolerable.

149. Dames & Moore v. Regan, 453 U.S. 654, 687 (1981).

150. *Koenings*, 126 Wis. 2d at 361, 377 N.W.2d at 599.

151. *Id.* at 365-66, 377 N.W.2d at 602.

Generally, whenever a dispute arises regarding the amount of stipulated damages, if the amount is reasonably related to the anticipated or actual damages and is not otherwise excessive, a defense of unconscionability will not succeed.[152] The court's broad-based damage analysis removed from the compensation clause any hint of waste, excess, or unconscionability. This conclusion was doubtless bolstered by the fact that Koenings' ultimate award was 44,416.66 dollars—less than one year's salary.[153] Like the contract in *Koenings*, a well-drafted golden parachute can also compensate for a broad range of objectively ascertainable losses, which, applying the *Koenings* damage analysis, can be upheld in the context of a stipulated damages clause.

Finally, in brief treatment, the court in *Koenings* said that the mitigation of damages issue was irrelevant if the stipulated damage clause was found to be reasonable.[154] As in *McMahon*,[155] the necessary implication of such a view is that once the reasonableness of the compensation clause is established, the parachute award accrues as an absolute right. No further judicial inquiry is merited. One commentator urges that inclusion of a mitigation clause will enhance the likelihood that the contract will be upheld if challenged.[156] Although the practical wisdom of this suggestion cannot be doubted, such a conclusion rests on the assumption that the golden parachute is something other than a traditional employment contract.[157] Judicial treatment has not expressed the same concern, however, for mitigation was expressly rejected in *Koenings* and was not even mentioned in *McMahon* or *Worth*.

Within the context of a written employment contract, a stipulated damages clause can encompass many of the elements the golden parachute purports to embrace. By establishing its own terms for performance, a party injured by breach of promise finds the damage clause to be automatically triggered. Likewise, the golden parachute is triggered by a reduction in job status (or actual termination) contrary to prior agreement. While critics debate the reasonableness of parachute benefits, the liquidated damage analysis provides a framework for ascertaining reasonableness and voids unconscionable awards. As with severance and option contracts, the liquidated damage analysis provides a traditional and predictable analytical model with which to scrutinize some elements of the golden parachute.

152. *In re* D. Federico Co., 25 Bankr. 822, 832 (D. Mass. 1982), *aff'd sub nom.* D. Federico Co. v. New Bedford Redev. Auth., 723 F.2d 122 (1983). *See* Ramada Dev. Co. v. United States Fidelity & Guar. Co., 626 F.2d 517 (6th Cir. 1980).

153. *Koenings*, 126 Wis. 2d at 357, 377 N.W.2d at 597-98.

154. *Id.* at 361, 377 N.W.2d at 599.

155. Royal Crown Cos. v. McMahon, 183 Ga. App. 543, 359 S.E.2d 379, *cert. denied*, 183 Ga. App. 907 (1987).

156. Profusek, *supra* note 117, at 104.

157. *Id.* Profusek notes the general absence of mitigation clauses in severance pay contracts. The recent cases, all of which postdate his article, seem to suggest that courts are not much concerned with mitigation of damages especially when the awards seem reasonable.

VI. Interpretive Analysis

The most recent and by far the most thorough case to deal with golden parachutes is *Worth v. Huntington Bancshares, Inc.*[158] *Worth* demonstrated the continued vitality of traditional contract analysis by utilizing a straightforward interpretive approach in scrutinizing the termination agreement. By applying the business judgment rule and focusing on the actions of the plaintiff, the court upheld the validity of the contract while denying its benefits to Worth.[159]

A. *Interpretation*

The overarching principle of contract interpretation is that courts are free to look at the totality of relevant circumstances surrounding a given transaction,[160] including acts or statements of parties in prior negotiations and any applicable course of dealing, course of performance, or usage of trade if such factors are used to give meaning to the contract terms.[161] The purpose of so broad an inquiry is to construe contractual provisions so as to effectuate the spirit and purpose of the original agreement.[162] The contract must be construed as a whole and interpreted to harmonize and give meaning to all its provisions.[163] "[An] interpretation which gives a reasonable meaning to all parts will be preferred to one which leaves a portion of it useless, inexplicable, inoperative, void, insignificant, meaningless, superfluous, or achieves a weird or whimsical result."[164] An overriding concern is that the agreement should not be interpreted in a manner that will place one party wholly at the will or mercy of another.[165] It is within the context of this traditional interpretive approach that the court examined Worth's golden parachute, focusing primarily on two issues: 1) whether Worth exercised his termination option in good faith;[166] and 2) whether golden parachutes generally are valid contracts.[167]

B. Worth *Examined*

The court of appeals began its analysis by noting that the trigger events required Worth's good faith determination as to whether his professional status or responsibility had been diminished,[168] and whether his resignation was based

158. 43 Ohio St. 3d 192, 540 N.E.2d 249 (1989), *aff'g* No. 52861 (Ohio Ct. App., 8th Dist., Nov. 25, 1987). Because the Ohio Supreme Court unanimously upheld the court of appeals, and because the appellate decision was so complete in its analysis, the appellate decision will serve as the basis for this section. *See also* its companion case, Orin v. Huntington Bancshares, Inc., No. 61129 (Cuy. County Ct. C.P. Sept. 30, 1986).

159. *Worth*, No. 52861, slip op. at 14-57.

160. E.A. Farnsworth, Contracts § 7.10 (1982).

161. *Id.*; A. Corbin, *supra* note 53, § 543.

162. Arizona *ex rel* Ariz. Dep't of Transp. v. United States, 216 Ct. Cl. 221, 235, 575 F.2d 855, 863 (1978).

163. *Id.*; Raytheon Co. v. United States, 2 Cl. Ct. 763, 768 (1983).

164. *Arizona*, 216 Ct. Cl. at 236, 575 F.2d at 863.

165. United States v. Board of Educ. of Chicago, 588 F. Supp. 132, 242 (N.D. Ill.) (citing The Padbloc Co. v. United States, 161 Ct. Cl. 369, 376-77 (1963)), *vacated*, 744 F.2d 1300 (7th Cir. 1984).

166. *Worth*, No. 52861, slip op. at 13-38.

167. *Id.* at 38-57.

168. *Id.* at 14.

on that determination.[169] Rejecting Worth's proffered definition of good faith,[170] the court instead agreed with the trial court that "the term 'good faith' is commonly characterized as one in which the party acting in good faith obligates himself not to act on speculative reasons."[171] In adopting a more common use of the term,[172] the court affirmed the previous findings that "diminished," "status," and "responsibility," though not precisely defined, comported with normal use, thus meriting denial of Worth's claim that the trial court's use of restrictive definitions constituted reversible error.[173] The court manifested the notion that parties to an agreement have used the language it contains in a way reasonable people ordinarily do.[174] Implicit in the court's rejection of Worth's subjective definition of good faith was the idea that to allow so speculative an action by Worth would place the defendant wholly at Worth's mercy without a meaningful way to ascertain the validity of the decision.[175] To bolster its contention that the parties had agreed to a working understanding of the mutual obligations regarding exercise of the termination option, the court examined relevant circumstances surrounding the discussions preceding issuance of the contract,[176] including testimony of the drafters.[177] Important also was evidence of Worth's motives, such as his refusal to seek accurate information from superiors, his disenchantment with his job, his failure to seek work locally, and his desire to return to his home state.[178] This intensive examination of the factual circumstances surrounding both the contract's drafting and Worth's subsequent exercise of the termination clause is a classic example of a court inquiring into events surrounding a contract in order to give meaning to its terms and to establish the parties' conformity to the agreement.[179]

The court went on to analyze the validity of the contract itself by application of two conventional norms of contract and corporate law: the ratification theory[180] and the business judgment rule.[181] As a preliminary matter, *Worth*, consistent with *McMahon*, rejected Huntington's argument that the contract was not supported by consideration.[182] It cited the retention of top-quality senior management as a benefit to the corporation and employment foregone as a detriment to the employee.[183] The court so held despite the fact that the con-

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169. *See id.* app. at III.
170. Worth contended that only a showing of subjective good faith was required in the contract. *Id.* at 15.
171. *Id.* at 17.
172. *See, e.g.*, Doyle v. Gordon, 158 N.Y.S.2d 248, 259-60 (Sup. Ct. 1954).
173. *Worth*, No. 52861, slip op. at 13-38.
174. *See, e.g.*, Wabash, Inc. v. Avnot, Inc., 516 F. Supp. 995, 998 (N.D. Ill. 1981); E.A. FARNSWORTH, *supra* note 160, § 7.11.
175. *See supra* text accompanying notes 14-29, 164-65.
176. *See supra* notes 160-61 and accompanying text.
177. *Worth*, No. 52861, slip op. at 18.
178. *Id.* at 27-29.
179. *See* Frigaliment Importing Co. v. B.N.S. Int'l Sales Corp., 190 F. Supp. 116 (S.D.N.Y. 1960).
180. *Worth*, No. 52861, slip op. at 42.
181. *Id.* at 46. *See* United Copper Sec. Co. v. Amalgamated Copper Co., 244 U.S. 261, 263-64 (1917); Note, *supra* note 3.
182. *Worth*, No. 52861, slip op. at 45.
183. *Id. See also* Orin v. Huntington Bancshares, Inc., No. 61129, slip op. at 20 (Cuy. County Ct. C.P. Sept. 30, 1986).

tract was issued after Worth had become an employee, as distinguished from golden parachutes issued as part of an integrated employment contract.[184] It appears well settled, especially in light of the stock option[185] and severance cases,[186] that inducements offered subsequent to employment, designed to retain employees, are presumptively valid concerning consideration, whether in the context of employment at will or a written employment contract.

Worth also dismissed challenges of self-dealing on the theory of ratification.[187] The court observed that Huntington knew of Worth's contract prior to its acquisition of UCB and that by its acquiescence it impliedly ratified the agreement.[188] As in *Kerbs*, *Koenings*, and *McMahon*, the self-dealing argument was sufficiently answered by a showing of shareholder approval upon full disclosure of the golden parachute agreement.

Finally, in response to Huntington's charge that the contract was a waste of corporate assets, the *Worth* court used the business judgment rule[189] to examine the contract's validity.[190] Noting that the business judgment rule "mandates inquiry into the facts and circumstances . . . to ascertain whether the . . . decision [to issue the contract] was an . . . informed [one],"[191] the court scrutinized the change-of-control clause, the termination clause, and the compensation clause.[192] Because the term "golden parachute" was not legally significant,[193] the court instead examined each clause for its reasonableness and conformity to legitimate corporate concerns.[194]

The change-of-control clause required the acquiring company to obtain at least thirty percent of Huntington's stock.[195] The court used a fact-specific inquiry into the exact proportion of stock required to trigger the clause, noting that its purpose was to identify corporate changes that could threaten the executive's career.[196] Should the clause be found to require only a nominal stock acquisition, the contract should be invalidated, the court argued, as providing a windfall and not really protecting against a true threat to the executive.[197]

The court is correct on this point, but for the wrong reasons. First, it is true that a nominal acquisition ought to be insufficient to trigger the contract, but this is so because any resulting change in the employee's status would not have

184. *Worth*, No. 52861, slip op. at 42-43 n.8; *See also* Koenings v. Joseph Schlitz Brewing Co., 126 Wis. 2d 349, 350, 377 N.W.2d 593, 595 (1985).

185. *See supra* Part IV.

186. *See supra* Part III.

187. *Worth*, No. 52861, slip op. at 42. *See also* the court's discussion of self-dealing, *id.* at 50-51.

188. *Id.* at 42.

189. *See* United Copper Sec. Co. v. Amalgamated Copper Co., 244 U.S. 261, 263-64 (1917).

190. *Worth*, No. 52861, slip op. at 46-57. *See also* Note, *supra* note 3.

191. *Worth*, No. 52861, slip op. at 48 (quoting Arsh, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93, 100-04 (1979)).

192. *Id.* at 51-57.

193. This determination, implicit in the court of appeals decision, was made explicit by the supreme court. *Worth*, 43 Ohio St. 3d at 196, 540 N.E.2d at 254. *See Koenings*, 126 Wis. 2d at 360, 377 N.W.2d at 599; *McMahon*, 183 Ga. App. at 545, 359 S.E.2d at 381.

194. *Worth*, No. 52861, slip op. at 26-29.

195. *Worth*, No. 52861, slip op. at 53.

196. *Id.* at 51 (quoting Note, *supra* note 3, at 925).

197. *Id.* at 52.

resulted from an acquisition-related change in company policy. It is one thing to insulate executives from the hazards of merger-related dismissals; it is quite another to paralyze corporate policymaking by holding boards hostage to minor changes in the composition of the corporation's shareholders. Golden parachutes, if they serve any purpose at all, ought to protect against only takeover-related termination.

Second, though an executive may find life with a new corporation unpleasant, the fact that a new company is in charge is hardly career-threatening. Doubtless it threatens his job, but not his career. Competence and ability are the touchstones of performance; there is always room in the marketplace for talented executives.[198] While this argument loses some force in light of those jobs which require firm-specific knowledge[199] (because such skills are not always readily marketable), it is nevertheless strained to suggest that job loss is tantamount to career loss. Because career loss is more often based on competence, if a golden parachute serves to protect incompetence, it is economically inefficient and therefore wasteful of assets, and should be invalidated. Such a purpose would be so repugnant to public policy and common sense[200] that a court would be remiss not to void the contract on this point alone. Career threat ought not to be the rationale supporting the change-of-control clause.

Finally, it is curious that the court would denominate the change-of-control clause as one the purpose of which was to identify career-threatening situations, especially in light of its earlier pronouncement that the contract's purpose was to retain a valued employee.[201] Indeed, it was on the retention theory that the consideration was found to support the contract at all.[202] Moreover, the agreement did not purport to be one protecting Worth's career—it merely sought to retain his services. In light of the court's own findings, the logical purpose of the change-of-control clause is properly seen as the event for which the contract was issued and the condition precedent to the termination clause.[203]

The termination clause was upheld because it required Worth to exercise an objective good faith determination of job reduction before it could be exercised.[204] The court's insistence on an objective standard was doubtless motivated by the need to establish a test with which to measure the validity of the termination clause. Yet the issue of Worth's good faith seems misplaced in light of the *Koenings* court's observations about constructive termination.[205] If, as *Koenings* held, the employer is responsible for constructive termination (because it is the employer's decision to reduce job status or duty),[206] then the appropriate inquiry ought to have been whether there was in fact any such diminution. The correct focus, therefore, is on the job itself, not on the employee's decision to

198. Comment, *supra* note 41, at 532.
199. Note, *supra* note 3, at 917.
200. *See* Marathon Oil Co. v. Kleppe, 407 F. Supp. 1301, 1306 (D. Wyo. 1975).
201. *Worth*, No. 52861, slip op. at 43.
202. *See supra* notes 182-86 and accompanying text.
203. *Worth*, No. 52861, slip op. at 42.
204. *See supra* notes 170-79 and accompanying text.
205. *See supra* notes 142-49 and accompanying text.
206. *Koenings*, 126 Wis. 2d at 352, 377 N.W.2d at 596.

leave, and the test of diminution should be an objective examination of the surrounding facts. Such an examination in the *Worth* case could have changed the final result.

Finally, the compensation clause was found reasonable in light of two basic considerations: 1) a liquidated damages analysis; and 2) the Deficit Reduction Act of 1984.[207] The court's brief treatment of the compensation issue suggests that the statutory parameters were definitive in its analysis. Nevertheless, the court noted that the compensation clause should reflect the expected magnitude of the executive's loss,[208] and it endorsed *Koenings*' use of liquidated damages as an appropriate framework within which to assess the reasonableness of the compensation.[209]

Worth is important in several ways. It is consistent with its predecessors in rejecting the term "golden parachute" as being of probative value and in finding the contract to be valid and supported by consideration. Also intriguing is the fact that *Worth*, like *Koenings*, had no difficulty in upholding the golden parachute when issued to a mid-level employee rather than to a top policymaking executive, contrary to the implications of many commentators.[210]

Another point of crucial importance relates to the indemnity clause,[211] under which Huntington promised to pay the legal fees arising from any contested exercise of the contract. The Ohio Supreme Court held:

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207. *Worth*, No. 52861, slip op. at 55; The Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 7, 98 Stat. 494, and other tax provisions are beyond the scope of this Note. It should be noted, however, that the Act limits golden parachute payments to a maximum payment of three times the executive's annual salary. Payments beyond this amount will cause the corporation to lose its deduction for the payment and will cause a twenty percent excise tax to be imposed on the payment's beneficiary. For a more complete treatment of tax consequences, see generally Johnson, *supra* note 1.

208. *Worth*, No. 52861, slip op. at 55 (quoting Note, *supra* note 3, at 926).

209. *Id.* at 55.

210. *See* Profusek, *supra* note 117, at 99; Riger, *supra* note 23, at 15-16; Note, *supra* note 3, at 909; Note, *supra* note 4, at 957-58. Indeed, golden parachutes are now routinely given to employees who are not top officers. Deutsch, *supra* note 117.

211. Worth's contract contained the following indemnity clause:

5. *Enforcement Costs.* The Company is aware that upon the occurrence of a change in control the Board of Directors or a stockholder of the Company may then cause or attempt to cause the Company to refuse to comply with its obligations under this Agreement, or may cause or attempt to cause the Company to institute, or may institute, litigation seeking to have this Agreement declared unenforceable, or may take, or attempt to take, other action to deny Employee the benefits intended under this Agreement. In these circumstances, the purpose of this Agreement could be frustrated. It is the intent of the Company that Employee not be required to incur the expenses associated with the enforcement of his rights under this Agreement by litigation or other legal action because the cost and expense thereof would substantially detract from the benefits intended to be extended to Employee hereunder, nor be bound to negotiate any settlement of his rights hereunder under threat of incurring such expenses. Accordingly, if following a change in control it should appear to Employee that the Company has failed to comply with any of its obligations under this Agreement or in the event that the Company or any other person takes any action to declare this Agreement void or unenforceable, or institutes any litigation or other legal action designed to deny, diminish or to recover from, Employee the benefits intended to be provided to Employee hereunder, and that Employee has complied with all of his obligations under this Agreement, the Company irrevocably authorizes Employee from time to time to retain counsel of his choice at the expense of the Company as provided in this Section 5, to represent Employee in connection with the initiation or defense of any litigation or other legal action, whether by or against the Company or any Director, officer, stockholder or other person affiliated with the Company, in any jurisdiction. Notwithstanding any existing or prior attorney-client relationship between the Company and such counsel, the Company irrevocably consents to Employee entering into an attorney-client relationship with such counsel, and in that connection

> [T]he provision in Worth's agreement is not contingent on his success in enforcing the agreement's other provisions . . . . [W]here a contract provides for indemnification of legal expenses incurred by a party in enforcing or defending same, but does not make such indemnification contingent on success in enforcing the contract's other provisions, the party is entitled to indemnification of his legal expenses incurred in enforcing the contract notwithstanding his lack of success, provided the party has not acted in bad faith or with no colorable claim of success.[212]

Worth was awarded full legal fees.[213]

Most important, *Worth*, again like its predecessors, used conventional contract analysis to interpret the terms of the contract. Notwithstanding some analytical difficulties, the court demonstrated that golden parachutes are susceptible to close scrutiny and can be invalidated when recipients operate outside the contract's intent. *Worth* makes it clear that the courts are prepared to recognize golden parachutes as valid contracts. They are equally prepared to void them in the presence of bad faith.

VII. Proposal

The foregoing discussion demonstrates that the salient issues presented by golden parachutes may be addressed in the context of at least four traditional contract analyses: severance agreements, stock options, liquidated damages, and interpretive analysis. It is thus apparent that golden parachute agreements are nothing more than a modern variation on contracts that for years have been fixtures in the corporate firmament, validated by countless judges in countless courtrooms. It is in recognition of this fact that court decisions concerning golden parachutes are unanimous in rejecting the term itself as being of legal significance. Yet each court has applied a different analysis to the agreements, and while it is true that golden parachutes are not new, there is nonetheless a need to agree on a consistent judicial approach to their interpretation if judicial certainty and economy are to be served. In light of the increasing use of such contracts, it is likely that they will become a familiar presence in corporate litigation for some time. This Note will now propose a four-part analysis, based upon the foregoing contract principles, for analysis of golden parachutes.

A. *Test*

The following test embraces the concerns of the cases discussed above, addressing the principal issues of consideration, damages, corporate self-dealing, and performance. For a golden parachute to be valid, the following conjunctive questions must be answered in the affirmative:

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the Company and Employee agree that a confidential relationship shall exist between Employee and such counsel. The reasonable fees and expenses of counsel selected from time to time by Employee as hereinabove provided shall be paid or reimbursed to Employee by the Company on a regular, periodic basis upon presentation by Employee of a statement or statements prepared by such counsel in accordance with its customary practices, up to a maximum aggregate amount of $500,000.

43 Ohio St. 3d at 198 n.4, 540 N.E.2d at 256 n.4. *See also* Worth v. Aetna Casualty & Sur. Co., 32 Ohio St. 3d 238, 239-40, 513 N.E.2d 253, 255 (1987).

212. 43 Ohio St. 3d at 199-200, 540 N.E.2d at 257.

213. *Id.* at 200, 540 N.E.2d at 257.

1. Did the contract function to attract or retain the employee?
2. Was the award a reasonable forecast of harm?
3. Did the contract result from an arms-length transaction?
4. Did consideration in fact accrue to the corporation?

1. *Did the Contract Function to Attract or Retain the Employee?*

Under the common law, a contract must be supported by consideration if it is to be enforced.[214] The first prong of the proposed test is designed to answer this threshold question within the framework of the stock option and severance cases. Those cases consistently held that where a bonus was used to induce one to accept employment, the acceptance and resulting promise to work were sufficient consideration to support the bonus offered.[215] In *Gaillard v. Natomas Co.*, the court recognized that attraction of executives by use of a golden parachute is a valid corporate purpose and that the contract is enforceable if negotiated as part of an overall compensation package.[216] Therefore, if a golden parachute is used as an incentive to lure an executive to a firm, his or her acceptance is consideration, and the first prong of the test is satisfied.

The examined cases were also unanimous in their assertion that when a bonus or stock option was used to retain the services of one already employed, the employee's remaining with the company was sufficient consideration to support the offer.[217] The *McMahon* and *Worth* cases are in accord. In *Worth* the court held that "[there] existed sufficient consideration to support the golden parachute [because] . . . UCB benefited from the retention of senior management during a crisis period."[218] *McMahon* likewise held that because the contract's purpose was to retain McMahon during merger negotiations, his continued performance in an employment-at-will context constituted sufficient consideration to validate the agreement.[219] Finally, *Buckhorn* recognized that golden parachutes designed to retain key employees who were at risk in a hostile tender offer were a reasonable response to the perceived threat and were therefore a valid corporate endeavor.[220]

The California court in *Gaillard* rejected the retention theory, however, apparently because it believed that attraction and objectivity were the only purposes to be served by a golden parachute.[221] Yet a closer examination of the context of that offering reveals that merger negotiations had already commenced when the contracts were issued.[222] It is likely that the timing of the offer created presumptions of self-dealing that were too great for the court to

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214. *E.g.*, Baher v. Penn-O-Tex Oil Corp., 258 Minn. 533, 539, 104 N.W.2d 661, 665 (1960).
215. Kerbs v. California E. Airways, Inc., 33 Del. Ch. 69, 74, 90 A.2d 652, 656 (1952); Roberts v. Mays Mills, 184 N.C. 406, 410-11, 114 S.E. 530, 532-33 (1922); Zwolanek v. Baker Mfg. Co., 150 Wis. 517, 522-24, 137 N.W. 769, 772-73 (1912).
216. 208 Cal. App. 3d 1250, 1266, 256 Cal. Rptr. 702, 712 (1989).
217. *Kerbs*, 33 Del. Ch. at 74, 90 A.2d at 656; *Mays Mills*, 184 N.C. at 412, 114 S.E. at 533.
218. *Worth*, No. 52861, slip op. at 45.
219. 183 Ga. App. at 545, 359 S.E.2d at 381.
220. Buckhorn, Inc. v. Ropak Corp., 656 F. Supp. 209, 232 (S.D. Ohio), *aff'd*, 815 F.2d 70 (6th Cir. 1987).
221. 208 Cal. App. 3d at 1269-70, 256 Cal. Rptr. at 714.
222. *Id.* at 1269, 256 Cal. Rptr. at 714.

ignore. The court's failure to treat retention as a valid purpose should not be understood as a rejection of the validity of that concept, but rather as an endorsement of fact-finding that is intolerant of fraud. If in the judgment of the compensation committee, "ship jumping" is going to harm the corporation, any reasonable means used to preserve the organization constitutes a valid exercise of corporate power.

Crucial to this inquiry, however, is whether employment is terminable at the will of either party, for a pre-existing written employment contract for a term of years would establish an obligation for the employee to remain at work regardless of any takeover activity. Absent a reformation of the contract, fully disclosed and approved by shareholders, an offer of a golden parachute subsequent to a term employment contract would be void for lack of consideration. This is to be distinguished from the situation in *Koenings*, where the golden parachute and the written agreement, though offered subsequent to Koenings' employment, were offered together as an integrated contract. The entire contract was offered in the context of what was previously an employment-at-will situation, so Koenings was obligated neither to accept the contract nor to remain with Schlitz. Such an offer satisfies the proposed test. Following this analysis, when a golden parachute retains one not otherwise obligated to remain, it is supported by consideration.

2. *Was the Award a Reasonable Forecast of Harm?*

The inquiry for the stipulated damages cases was whether the amount stipulated bore a reasonable relationship to the anticipated losses.[223] Among the factors considered were actual damages, subsequent earnings, consequential damages, age, labor market, transferability of skills, and appropriate statutes.[224] Using these categories as a guide, the court is free to explore the totality of the circumstances to determine whether the award is a reasonable forecast of harm or whether it is so divergent from reasonable expectations that it would "seem shockingly large."[225]

The key inquiry will revolve around the reasonableness of the award, for the Internal Revenue Code dictates that any amount shown to be " 'reasonable compensation for personal services *actually rendered* before the date of the change' " will not be considered excessive compensation.[226] Factors of probative value will include "the work performed, the training and experience involved, the results obtained, the need for unusual ability and talent, the inadequacy of compensation in prior years, and the compensation paid by similar businesses for comparable services."[227] These factors are not exhaustive, however, because they address primarily performance-based indicia for executive parachutes. Mid-level employees are perhaps the more frequent recipients of parachutes,

223. Layton Mfg. Co. v. Dulien Steel, Inc., 277 Or. 343, 347, 560 P.2d 1058, 1060 (1977); Koenings v. Joseph Schlitz Brewing Co., 126 Wis. 2d 349, 363, 377 N.W.2d 593, 600-01 (1985).

224. *See supra* notes 21-30, 150-53 and accompanying text.

225. Kerbs v. California E. Airways, Inc., 33 Del. Ch. 69, 78, 90 A.2d 652, 658 (1952).

226. Johnson, *supra* note 1, at 131 (quoting I.R.C. § 280G(b)(4)(B) (1986)).

227. *Id.* at 135.

and these contracts are the most justifiable in terms of effective and reasonable responses to threatened takeovers.[228] In this context the courts should look at the likelihood of the employee's departure, the probable impact upon the corporation of that departure, and the availability within the relevant labor market of similarly skilled workers.

While this approach affords the court great latitude, it must be remembered that the golden parachute is primarily a severance agreement, designed to compensate displaced employees. It is "remuneration for the service rendered"[229] the corporation, and once performed, it accrues to the employee and may not be voided unless it is unconscionable. Unconscionability will be determined in light of current corporate practice and judicial treatment. The liquidated damages analysis is merely a convenient tool facilitating judicial inquiry.

3. *Did the Contract Result from an Arms-Length Transaction?*

To answer this question, the court need only examine the extent to which the golden parachute was fully disclosed to voting shareholders, whether it received their approval, and whether the amount and number of parachutes offered constituted a reasonable response to a perceived threat. In the event the challenge to the contract arises after a takeover has been consummated, the question is whether the acquiring corporation ratified the contract at the time of the merger. The stock option and golden parachute cases are unanimous in upholding contracts fully disclosed and ratified. While it may be argued that the modern shareholder is frequently far removed from the actual operations of the firm and is therefore ill equipped to render an informed decision, the law still recognizes him or her as the final voice in corporate affairs. Though this concept may be a fiction, it is the only yardstick available to measure disclosure.

4. *Did the Consideration in Fact Accrue to the Corporation?*

The central concern of the *Kerbs* court was that the contract, by either explicit terms or trustworthy circumstances, guarantee that the corporation receive the consideration it sought.[230] As already demonstrated, when validly exercised, golden parachutes necessarily promise full performance before execution is possible.[231]

The proper inquiry under this prong of the test is a factual one, focusing on whether the change-of-control clause was properly triggered and whether the

228. If one is to accept the rationale that preservation of the corporate infrastructure is of paramount concern in the face of a threatened takeover, then retaining key employees is as important, perhaps more so, as retaining high-level executives. In *Buckhorn, Inc. v. Ropak Corp.*, the court was persuaded that corporate survival depended upon such continuity and upheld parachutes for employees other than the chief executive. 656 F. Supp. 209, 232 (S.D. Ohio), *aff'd*, 815 F.2d 70 (6th Cir. 1987). Worth and Koenings were also mid-level employees, and those courts also endorsed their contracts. The golden parachute discussion, therefore, ought to include within its scope treatment of this type of employee.

229. *See supra* text accompanying note 55.

230. *Kerbs*, 33 Del. Ch. at 74, 90 A.2d at 656.

231. *See supra* notes 127-30 and accompanying text.

termination option specified material and verifiable reductions in job status or responsibility. The test the court should apply is whether the objectively ascertainable facts surrounding the alleged constructive termination support an inference that a diminution of job duties actually occurred. Following *Worth*,[232] this will be the focal point of a most intense scrutiny. Yet the proper focus, unlike *Worth*, should be limited to whether or not a diminution in status or responsibility *in fact* took place. The subjective intent of the contract holder ought not to be dispositive, nor should an honest, though mistaken, exercise of the termination clause bar recovery. The central inquiry is whether the employer has failed to keep promises, implicit or explicit, that went to the basis of the bargain struck between the parties. Good faith ought to be of probative value only in the context of self-dealing and overreaching. Finally, the important concerns expressed regarding suboptimal mergers, acceleration of benefits, and corporate entrenchment may be addressed in this part of the analysis, and the contract may be voided if the executive's behavior fails to pass muster.

VIII. CONCLUSION

The foregoing analysis has demonstrated that golden parachutes may be analyzed in much the same way as are traditional employment and incentive contracts. This analysis has avoided the ethical issues often cited in opposition to golden parachutes because such arguments ignore the fact that under current contract law, these agreements are valid and enforceable. In recognition of that fact, it is best that courts adopt a uniform analysis that will penetrate and void those agreements that in fact are wasteful or frivolously executed and uphold those which are properly exercised.

Drew Harrison Campbell

232. *Worth*, No. 52861, slip op. at 11-38.